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2012 BDO REITs RISKFACTOR REPORT

ECONOMIC & FEDERAL POLICY UNCERTAINTY HINDERS RECOVERY FOR REITs

The ***2012 BDO RiskFactor Report for REITs*** examines the risk factors in the most recent 10-K filings of the largest 100 publicly traded U.S. real estate investment trusts (REITs); the factors are analyzed and ranked by order of frequency cited.

The real estate industry continues to feel the repercussions of high unemployment rates, declining and stagnating property values and a lack of consumer spending as a result of the slow economic recovery. Prudence in bank lending practices continues to make access to capital difficult, while the ability to deploy existing capital in a strategic method due to increased competition remains challenging. In order to mitigate general economic threats, REITs are aiming to capitalize on low interest rates and acquire assets in prime real estate locations.

"Economic conditions in the broader economy are a bellwether for how REITs are performing," said **Stuart Eisenberg, partner and national Real Estate industry practice leader at BDO USA, LLP**. "The key determinants of profitability for REITs in 2012 are properties with strong fundamentals, namely financially stable tenants in a prime location."

CONTACT:

STUART EISENBERG
New York
212-885-8431 / seisenberg@bdo.com

BRENT HORAK
Dallas
214-665-0661 / lhorak@bdo.com

ALBERT LOPEZ
Miami
305-381-8000 / alopez@bdo.com

JAMES NESBITT
Washington, D.C.
301-634-0223 / jnesbitt@bdo.com

JOHN RAINIS
Chicago
312-616-4644 / jrainis@bdo.com

CHRISTOPHER TOWER
Orange County
714-668-7320 / ctower@bdo.com

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▶CREDIT SHORTAGE IS EXACERBATED BY THE REAL ESTATE INDUSTRY'S PESSIMISTIC FINANCIAL OUTLOOK

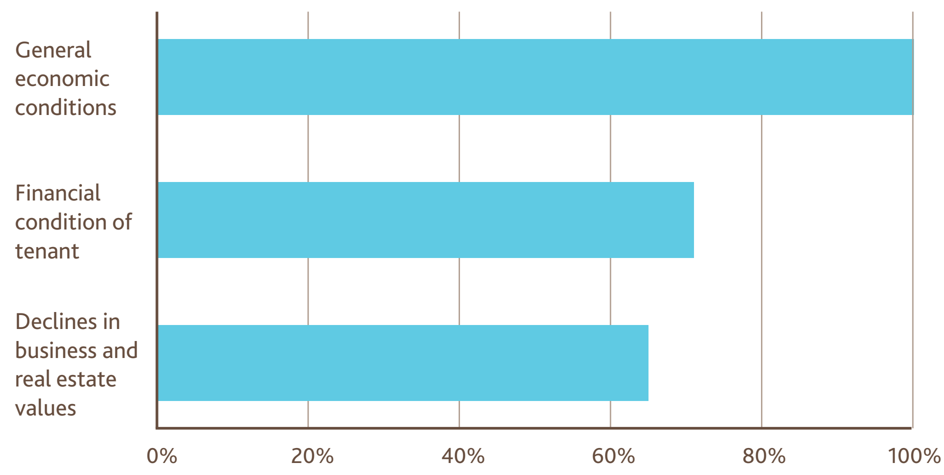
Nearly all REITs (97 percent) cited access to capital and financing as a top risk of doing business. REITs are looking to refinance existing properties; however, they are facing a roadblock with banks and other lenders as they deem the real estate industry's loan to value ratio too high. The credit shortage can be attributed in part to the industry's current financial outlook. The future value of a piece of property is tricky to predict, and in the recent past, declining business and real estate values have resulted in an increase of asset impairment – a risk for nearly two-thirds (65 percent) of the REITs analyzed in the study. Further exacerbating the ability to access capital is indebtedness, a concern for 90 percent of the REITs analyzed in the study. Nearly four in five REITs also noted concerns over strict debt/financial covenant restrictions.

"The uncertainties with respect to the economy have clouded the financial outlook for the real estate industry. This uncertainty has resulted in difficulties in determining property values, making it challenging to determine the appropriate mix of debt and equity financing for acquisitions," said Eisenberg. "As a result, lenders are erring on the side of caution when it comes to extending credit to real estate investors."

▶REITs FACE EXPOSURE TO DEVELOPMENT AND CONSTRUCTION RISKS

High permit costs and delays in, or abandonment of, construction projects contribute to the majority (72 percent) of REITs citing development and construction as a top concern. Failure by a REIT to realize its development and redevelopment plans may compromise profitability and, more broadly, its overall business strategy. While the majority of REITs foresee development and construction as posing significant risk to their financial strength, multi-family REITs are ripe for growth and development, with increased rental demand spurring from the foreclosure crisis and a lack of supply from a previously arrested period in development. At the same time, retail REITs face continued threats from increased online and mobile shopping, as well as low consumer spending that has stunted U.S. development in the sector.

Slow Economic Recovery Causes Concern



▶PERVASIVE COMPETITION DETERMINES BUSINESS AND ACQUISITION STRATEGY

According to the survey, 93 percent of REITs face competition for prime real estate and tenants. Much of this competition is derived from consumer attitudes toward a neighborhood or property type. As areas and property types fall in and out of fashion, one major component to maintaining a successful REIT is the ability to make acquisitions in "A" areas that attract top tenants. In a highly motivated acquisition climate, REITs are competing for these properties, not just with industry counterparts, but also with non-traditional competitors including private equity funds and foreign investors. As a result, it is no surprise that M&A is a concern for 90 percent of REITs.

"For private equity funds, there are several factors driving investments in real estate. First, funds have significant capital that they wish to deploy, but there is a perceived dearth of quality target companies, and second, funds are looking to diversify their asset risks," said **Lee Duran, partner and Private Equity practice leader at BDO USA, LLP**. "However, with significant capital chasing a limited number of deemed acceptable "A" market properties, market cap rates have declined. In the long term, private equity funds will be looking to strengthen yields through investments in broader market segments or distressed properties."

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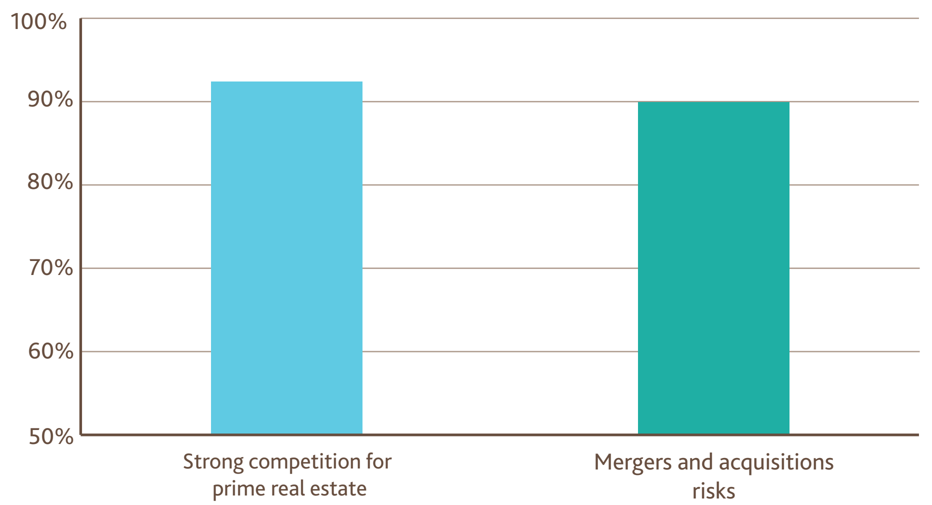
▶REGULATORY POLICY UNCERTAINTY AN ISSUE FOR REITs

REIT status allows organizations to avoid being taxed as corporations, affording investors high distribution payments. Therefore, it is no surprise that all of the top 100 organizations analyzed consider failing to qualify for REIT status as a principal risk. Furthermore, 79 percent of REITs are concerned about the tax laws and potential rate increases directly impacting operations such as owning and developing properties. Overall, 94 percent of REITs are concerned about federal, state or local regulations impacting how they do business.

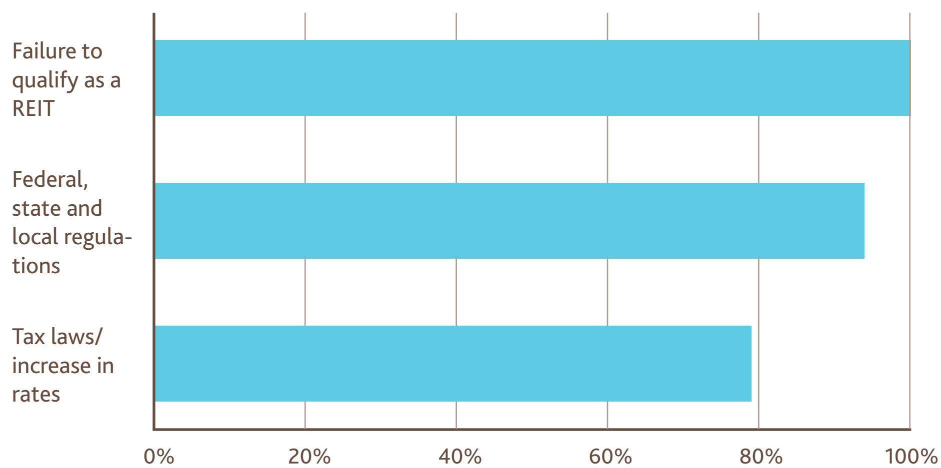
▶INTEREST RATE CHANGES ARE A TOP CONCERN

When it comes to federal monetary policy, the vast majority of REITs (92 percent) are closely watching interest rates. While REITs continue to be an attractive investment as interest rates remain near zero, it is unclear how the Federal Reserve will act as the economy recovers. Despite the central bank's plan to keep interest rates down until 2014, there is no guarantee that rates will not rise sooner, which would impact overall real estate investing, refinancing and cash flow.

Competition for Attractive Properties and Investments Fuels Risks



Qualifying as a REIT is a Top Priority Amid Heavy Regulation and Tax Concerns



"REITs are keeping a watchful eye on federal fiscal and monetary policy because changes to taxation regulations and interest rates could force them to change how they do business," said **Richard Hauer, managing director at BDO Consulting and member of the Real Estate practice at BDO USA, LLP**. "An increase in interest rates would directly impact REITs on both sides of the ledger. Not only will REITs be a less attractive investment compared to safer instruments like bonds, but refinancing existing loans in order to access capital would also be more expensive."

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The ***RiskFactor Report for REITs*** indicates that REITs are still facing significant challenges even as the broader economy starts to recover. In particular, the ability to access and deploy capital remains a major hurdle. Lenders are loath to provide financing to REITs due to depressed property valuations and a pessimistic financial outlook. For those REITs that do have capital to deploy, strong competition from non-traditional sources such as private equity firms is forcing them to look at riskier projects in order to meet investment return objectives. Pervading these operational challenges is uncertainty in the regulatory environment, where changes to current monetary and fiscal policy will directly impact REITs' revenue and profitability.

The Top 25 Risks for REITs

2012 Rank	Risk Factors Cited in 10-K Filing	
1.	General economic conditions	100%
1t.	Failure to qualify as REIT; ability to make distributions	100%
3.	Inability to acquire capital or financing	97%
4.	Federal, state or local regulations	94%
5.	Strong competition for leases and prime real estate	93%
6.	Increases in interest rates; hedging risks	92%
7.	Environmental liability	91%
8.	Indebtedness	90%
8t.	Mergers and acquisitions, joint ventures and partnerships	90%
10.	Inability to sell properties quickly	89%
11.	Inadequate insurance and potential losses due to uninsured liabilities	86%
12.	Anti-takeover and change-of-control provisions	84%
13.	Natural disasters, war, conflicts and terrorist attacks	83%
14.	Operating expenses and costs of capital improvements	80%
15.	Tax laws and potential rate increases	79%
15t.	Debt/financial covenant restrictions	79%
17.	Development and construction risks	72%
18.	Financial condition of tenants	71%
19.	Ability to attract and retain key personnel	68%
19t.	Payments of common and preferred stock	68%
21.	Declines or stagnation in business and real estate values; asset impairment	65%
22.	Revenue and stock fluctuation	57%
23.	Legal proceedings	53%
23t.	Credit risk	53%
25.	Portfolio diversity	50%
25t.	Dodd-Frank and derivatives legislation	63%

*t – indicates a tie in the risk factor ranking

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With extensive industry knowledge, the partners and directors in BDO's Real Estate practice are value-driven advisors who offer accounting and tax experience in both the national and international commercial real estate arenas. The practice services a wide range of clients including middle-market real estate operating companies (REOCs), developers and real estate investment trusts, providing quality and timely guidance on major financial matters.

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